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IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

NO. 157

LAWRENCE C. PHIPPS, Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

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Citations.

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Lawrence C. Phipps, the petitioner above-named, respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Tenth Circuit, entered in this case on March 23, 1942.

Opinions Below.

The opinion of the United States Board of Tax Appeals (R. 24-49) is reported in 43 B. T. A. 1010. The opinion and the dissenting opinion of the Circuit Court of Appeals (R. 183-194) are reported in 127 F. (2d) 214.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on March 23, 1942 (R. 194). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

1. Whether the Board of Tax Appeals and the Circuit Court of Appeals erred in failing to apply the principle of "blockage" in the valuation for gift tax purposes of 10,000 shares of preferred stock of Nevada-California Electric Corporation given by the petitioner in various amounts to thirteen individuals on October 15, 1935.

2. Whether the petitioner is prevented by the doctrine of election, ratification or estoppel from claiming for the year 1935 a portion of his $50,000 gift tax exemption given him by Section 505(a) of the Revenue Act of 1932, where the Commissioner without a claim therefor by the petitioner applied such portion in determining a deficiency in gift taxes for 1933 which the petitioner unsuccessfully contested before the Board of Tax Appeals and the Circuit Court of Appeals, and the decision of the Board in the 1933 proceeding did not become final until after the petitioner had given notice of his election to claim the disputed exemption for the year 1935.

Statutes and Regulations Involved.

The statutes and regulations involved may be found in the appendix *infra,* pp. 18-20.

Statement.

The following material facts with respect to the first question are contained in the findings of the Board of Tax Appeals (R. 27-32) and the evidence (R. 57-180):

On October 15, 1935, the petitioner made gifts totalling 10,000 shares of 7% cumulative preferred stock of Nevada-California Electric Corporation to twelve members of his family and to his secretary, of which one person received 2,500 shares, two persons 1,250 shares each, four persons 1,000 shares each, two persons 300 shares each and four persons 100 shares each. The petitioner reported the value of each gift of this stock at $50 a share, which he believed was the market price in Denver of small blocks of the stock on the date closest to the date of the gifts. (R. 27, 68, 82.) The Commissioner increased the value of each gift to $51 a share, the price at which 50 shares had sold on the New York Curb Exchange on October 15, 1935. (R. 27-28, 180.) In his petition to the Board the petitioner alleged that the value of the stock on the date of the gifts was $40 a share. (R. 28.)

The Nevada-California Electric Corporation was a holding company in 1935, owning nine subsidiary utilities operating companies in the region of California and Nevada. Its authorized capital stock consisted of $25,000,000 par value preferred stock and $25,000,000 par value common stock. As of December 31, 1934, the preferred stock outstanding in the hands of the public was $10,483,300, par value $100 a share; and the outstanding common stock was $8,468,300. (R. 28.) As of November 12, 1935, the preferred stock was held by 1,163 individuals. One stockholder held a block of from 10,000 to 20,000 shares and no one person held more than 20,000 shares; ten stockholders held a block of from 2,000 to 10,000 shares; ten persons held from 1,000 to

2,000 shares; 52 persons held from 200 to 1,000 shares; 72 persons held from 100 to 200 shares; and 1018 stockholders held stock in lots of less than 100 shares. (R. 29.)

Ownership of the preferred stock was concentrated in California (523 stockholders) and Nevada (472 stockholders). Otherwise ownership throughout the United States was scattered thinly, there being 168 stockholders in thirty other states. The market for the stock was concentrated in Denver, where transactions took place over the counter. The stock could be listed on the New York Curb Exchange but it was not dealt in on that exchange except infrequently. Transactions from other cities than Denver were frequently carried out in Denver. (R. 29.)

Market quotations in general in 1935 showed advances in prices of securities from March to the end of the year. Market prices of stocks of utility companies advanced during 1935 and during October 1935. Market prices of comparable 7% preferred utilities stocks advanced in October of 1935. (R. 29.) In Denver transactions over the counter showed increases in market prices of the Nevada-California Electric Corporation preferred stock as follows (R. 30):

	High	Low		High	Low
January	44	37	July	48	43
February	43	38.25	August	50	44
March	43	37.65	September	48	43.50
April	44.25	38	October	55.50	46.25
May	44.50	40.25	November	68	59
June	45.75	42	December	70	64

On the New York Curb Exchange sales were made at the following prices (R. 30):

		High	Low
September		45	45
October		51	51
November	(sic)	53	60
		60	60

Transactions in this stock in Denver during 1935 usually were in small lots of 10, 25, 50 and 100 shares, or in lots of around such numbers.[1] There were around 28 transactions involving the purchase or sale of the preferred stock in lots of 100 shares or close to that number. There were 6 transactions involving purchases or sales in lots of from 150 to 250 shares; 3 transactions involving from 300 to 550 share lots; 1 transaction involving a purchase of 800 shares; and 1 transaction involving a sale of 1,000 shares. During 1935 the purchases or sales of the preferred stock on the New York Curb Exchange involved 275 shares. (R. 30.)

Three expert witnesses on behalf of the petitioner testified that no group or individual purchaser for a block of 10,000 shares of preferred stock could have been found on the valuation date at the price of $51 a share. (R. 93, 111, 120, 137.) They gave their opinion that the best price obtainable for such a block of stock between a willing buyer and a willing seller on that date was respectively $41, $38, and $40 a share. (R. 99, 112, 122, 136.)

The Commissioner's one witness testified that 2,000 shares of this stock would be sold on the critical date

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1. The Board also found that trading in Denver during 1935, purchases and sales, involved at least 10.946 shares. (R. 30.) This constituted a misconstruction of Joint Exhibit A-8 (R. 173-180), inasmuch as many of the sales between the brokers in that exhibit must have been duplications. The transfer records of the stock showed that in 1935, exclusive of the gift stock, approximately 6,200 shares were transferred. (R. 97.)

at $51 a share (R. 156) and that the same price would apply in the case of a block of 10,000 shares (R. 157) or 100,000 shares, or of all the 104,833 outstanding shares (R. 168).

The Board of Tax Appeals held that the property to be valued was not a block of 10,000 shares but 13 separate blocks ranging from 100 to 2,500 shares. (R. 40). It found "on the basis of all the evidence" (R. 49) that the value of each gift was $51 per share. (R. 32.) The Circuit Court of Appeals with one dissent affirmed the Board on this point. (R. 186-188, 191-194.)

The following are the material facts with respect to the second question, taken from the findings of the Board (R. 25-27):

The petitioner claimed and was allowed a specific exemption of $12,000 in the computation of his gift tax liability for the year 1932. Thereafter the limit on his exemption in computing gift tax liability under Section 505(a) of the Revenue Act of 1932 was $38,000. (R. 25.)

The petitioner in his return for 1933 reported gifts aggregating $76,850, exclusive of gifts of first Liberty Loan bonds, stating in the return that he believed the gift of the Liberty bonds was not subject to Federal gift tax. He claimed a specific exemption of $11,850 in the return against the reported gifts. (R. 25, 26.)

Upon auditing the 1933 return the Commissioner determined that the gifts of the Liberty bonds were taxable and increased the aggregate of gifts to $240,433.33, at the same time increasing the deduction for the specific exemption from $11,850 to $38,000. The Commissioner, accordingly, by a deficiency notice mailed February 28, 1935, determined a deficiency in the petitioner's gift tax for 1933 of $4,108.17. On March 27, 1935, the petitioner filed a petition with the Board contesting only the Commissioner's action in increasing the total amount

of the gifts made in 1933. The Board sustained the Commissioner's determination (*Lawrence C. Phipps,* 34 B. T. A. 641) and entered its decision on June 10, 1936 finding a deficiency in gift tax for 1933 in the amount of $4,108.17. On appeal to the Circuit Court of Appeals the Board's determination and decision was affirmed (*Phipps v. Commissioner,* 91 F. (2d) 627). This Court denied certiorari (302 U. S. 742). (R. 26.)

The petitioner filed a gift tax return for the year 1934 but made no claim for a deduction for specific exemption. In his gift tax return for the year 1935 he claimed a specific exemption of $26,150, that amount being the difference between $50,000 and the sum of $23,850 which had theretofore been claimed by him in his returns for 1932 and 1933. On July 20, 1936, the Commissioner advised the petitioner that he proposed to determine a deficiency in gift tax for 1935 which would result in part from a disallowance of the petitioner's claim for a deduction of $26,150 as a specific exemption. The Commissioner gave as an explanation the following: "Specific exemption of $50,000 has been allowed as follows, calendar year 1932—$12,000 and calendar year 1933—$38,000." Thereupon petitioner, on or after August 7, 1936, filed a protest with the Commissioner in which he excepted to the Commissioner's proposed disallowance of the specific exemption of $26,150, among other things. In the protest petitioner stated that he had taken at his "option" the allowable specific exemption of $50,000 in the years 1932, 1933, and 1935 in the sums of $12,000, $11,850, and $26,150, respectively, and that it was his "selection and desire that said exemption be allowed in said years as chosen by him." Petitioner also stated in the protest: "The Commissioner has assigned all of said specific exemption to years prior to 1934." (R. 26-27.)

The Board of Tax Appeals held that the petitioner was not entitled to any portion of the exemption of $26,150 claimed for the year 1935 on the ground that the petitioner acquiesced in the Commissioner's allowance of the exemption for the year 1933 and could not be heard to say that he elected to receive less than the amount allowed by the Commissioner for that year. (R. 36-37.) The Circuit Court of Appeals with one dissent affirmed the decision of the Board on this point also. (R. 184-186, 188-191.)

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

1. In failing to hold that the Board of Tax Appeals should have applied the blockage theory in the valuation of the gifts of Nevada-California Electric Corporation stock made by the petitioner on October 15, 1935.

2. In failing to hold that the Board should have determined a valuation on the basis of a block of 10,000 shares of Nevada-California Electric Corporation preferred stock.

3. In holding that there was substantial evidence in the record which supported the valuation of the Board.

4. In failing to reverse and remand the case to the Board for the purpose of giving effect to the blockage theory in the valuation of the gifts of Nevada-California Electric Corporation stock made by the petitioner on October 15, 1935.

5. In holding that the petitioner might not challenge the action of the Commissioner in increasing the amount of the petitioner's specific gift tax exemption for the year 1933.

6. In holding that the petitioner ratified the action of the Commissioner in increasing his exemption in his 1933 gift tax return.

7. In holding that the petitioner was not entitled to claim an exemption of $26,150 in his gift tax return for the year 1935.

Reasons for Granting the Writ.

1. The decision of the Circuit Court of Appeals in affirming the decision of the Board conflicts in principle with a number of recent decisions of other Circuit Courts of Appeals which have held that the blockage theory was properly taken into account in valuing a large block of stock for estate or gift tax purposes. *Helvering v. Maytag,* 125 F. (2d) 55 (C. C. A. 8th), certiorari denied May 25, 1942, Nos. 1161, 1162, October Term 1941; *Commissioner v. Shattuck,* 97 F. (2d) 790 (C. C. A. 7th); *Helvering v. Kimberly,* 97 F. (2d) 433 (C. C. A. 4th); *Helvering v. Safe Deposit & Trust Co. of Baltimore,* 95 F. (2d) 806 (C. C. A. 4th); *Page v. Howell,* 116 F. (2d) 158, (C. C. A. 5th). But compare *Bull v. Smith,* 119 F. (2d) 490 (C. C. A. 2nd).

The blockage theory is based on the fact that an offering for sale of a block of stock which is extremely large in proportion to the usual sales will normally have the effect of depressing the market and reducing the price per share; that consequently this effect is to be considered in making a valuation of a large block of stock for estate or gift tax purposes. While the Board's opinion professed to have considered all of the evidence, including the testimony of the petitioner's witnesses concerning the effect of an attempt to dispose of a large block of the stock, in fact the decision failed to give any weight whatsoever to the blockage theory. Thus the Board said (R. 46):

"The foregoing clearly shows, in our opinion, that there was a fair market for the preferred stock. In our opinion the market price on the date of the gifts is the best evidence of the value per unit of the stock comprising each gift."

Again the Board said (R. 48-49):

"We believe it is a rather speculative assumption that if any one or all of the donees of the gifts in question looked to the market at the date of the gifts they would not find willing buyers for the stock involved in each gift, or that if buyers appeared they would not be willing to enter into transactions at market prices. * * *

"The property involved in each gift in this case was property which was regularly purchased and sold in an established market. The standard of value which at law is to be applied in valuing the property in question is 'fair market value.' Fair market value is evidenced here by established market price."

The Board had before it the testimony of three qualified witnesses for the petitioner, each of whom testified that no purchasers for a block of 10,000 shares of the stock could have been found at a price anywhere near $51 a share, the sale price of 50 shares on the critical date. (R. 93, 111, 137.) The witnesses' opinions as to the best price obtainable for such a block ranged from $38 to $41 a share. (R. 99, 112, 122, 136.) If it be conceded that the depressing effect of the offering of a large block is not a matter of "doctrinaire assumption" (*Safe Deposit & Trust Co. of Baltimore, Executor,* 35 B. T. A. 259, 263) but of proof, nevertheless, when proof is advanced by competent testimony on the subject and is not contradicted, it then becomes error not to follow it. This is not to say that it was incumbent on the Board to accept the exact amount of the reduction in market value

ascribed by the testimony to blockage, but under the circumstances the theory must be taken into account. While the amount of value involves a determination of fact, the question whether the proper criterion has been applied is one of law. *Powers v. Commissioner,* 312 U. S. 259, 260. Here the use of the exact amount of the sale price of a small block on the valuation date in the face of testimony that the normal market value would be reduced by reason of the size of the block to be valued, constitutes, we submit, a failure to observe the theory.

There is nothing which would demonstrate that the petitioner's expert witnesses were wrong in their view that the size of the block would depress the normal market. It is true that the Commissioner's witness testified that the market price of a large block would be the same as the sale price of 50 shares. But it appears that the testimony of this witness was based upon a theory which in reality gave no consideration to the effect of the offer of a block of stock which was large in proportion to the volume of trading. In other words, he evidently considered the questions put to him to assume an increase in the demand co-extensive with the increased supply.[2] Such a theory was advanced by the

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2. Thus the witness said (R. 154): "A. Well, I believe that under the conditions you mentioned above, there would be no increase in the stock on the market with a willing buyer and a willing seller, and that the transaction could be effected at the last sale, no change in supply and demand, as I see it." Again, the following occurred in his examination (R. 156): "Q. My question was on the assumption that a willing buyer and a willing seller appeared in the market, neither trading under any disadvantage, one being willing to sell and the other being willing to buy, and at what price, in your opinion, they would trade. * * * A. My answer is that 2,000 shares, under those ideal conditions, would probably be treated at 51. There might be an arbitrary figure somewhere between the bid and ask price, but there was a definite sale at 51, which indicated there were purchasers and there were sellers at that time."

Commissioner but not approved by the court in the *Maytag* case, *supra*. The error in principle on which the witness's opinion was based is made evident by his belief that it would make no difference even if 100,000 shares of the preferred stock or the whole outstanding issue of 104,833 shares were to be valued, but that the market value would still be $51, represented by the sale price of 50 shares. (R. 168.) The Board itself stated that the witness's testimony was to be given little weight. (R. 49.)

The Board in its opinion attempted to justify its refusal to give effect to the blockage theory applied by the petitioner's witnesses on the ground that their testimony showed they did not give sufficient consideration to the extent and the volume of trading in the Denver market and the trends of the market prices. (R. 46-47.) We believe there is nothing in the testimony of these witnesses to indicate a failure to take these factors into account. To the contrary, the testimony indicates that the witnesses gave consideration to the extent of the trading in the stock. (R. 97, 102, 109, 127-128, 133, 134, 137.) The volume of trading on the Denver market referred to by the Board (R. 173-180) was extremely small in proportion to the number of shares to be valued and thus supports the witnesses' opinions that the case is a proper one for the application of the blockage principle.

This was a volatile, speculative stock having a narrow market centered in Denver. (R. 67, 118, 119.) Transactions in the stock usually were in small lots. (R. 30.) The total transfers in the year 1935, exclusive of the gifts in question, amounted to approximately 6,200 shares or 3,800 less than were involved in the gifts made by the petitioner on October 15, 1935. (R. 44, 97.) We submit that under the circumstances of this case the failure of the Board to make any reduction from the

sale price by reason of the large block to be valued is a failure to take the blockage theory into account in a situation where its application is required by the evidence and that consequently the decision of the Circuit Court of Appeals which held that the Board might wholly disregard the testimony of the petitioner's witnesses conflicts in principle with the decisions above cited approving the application of the blockage rule.

2. It seems clear from the Board's opinion that it treated each gift separately for the purpose of finding market value per share rather than determining such value on the basis of an aggregate of 10,000 shares given by the petitioner at one and the same time and that the restriction to smaller blocks constituted an important factor in influencing the Board's refusal to give any weight to the blockage principle. This is evidenced by the discussion of the petitioner's position in this respect (R. 39-40), the reasons given for discarding the petitioner's basis of valuation (R. 40), and the subsequent discussion in the opinion (R. 46-47, 48). While the Circuit Court of Appeals stated (R. 187) that it found it unnecessary to decide this question because of other evidence which the court felt sustained the Board, nevertheless this in effect was an approval of the individual gift method of valuation. For if a valuation based upon the whole block given by the donor was proper the case should have been remanded to the Board for the purpose of taking this factor into account.

The courts and the Board in a number of decisions, generally without discussion of the point, have treated a block of stock divided among several donees as constituting a single unit for the purpose of valuation. See *Helvering v. Maytag, supra; Commissioner v. Shattuck, supra; Helvering v. Kimberly, supra; F. J. Sensenbrenner,* B. T. A. Memorandum Opinion, reported in CCH Dec. #9215-A; *Joseph Soss,* B. T. A. Memorandum

Opinion reported in CCH Dec. #11371-B. The decision in the present case is thus in apparent conflict with the basis on which the above cases were decided and the question so presented is a recurring one which should be authoritatively settled.

3. The Solicitor General stated in his petition for certiorari in the *Maytag* case that the ultimate place of the blockage theory in the field of valuation presents a problem of great importance and frequent recurrence in the administration of the estate and gift tax laws and that a conservative estimate of the amount of taxes turning on the validity of the theory is not less than $7,000,000, involved in 445 pending cases. Until recently the Treasury Regulations provided, contrary to the cases heretofore cited, that the size of the gift of any security or of the holdings of an estate is not a relevant factor and will not be considered in the determination of value. Regs. 79 (1936 Ed.) Art. 19(3), Appendix *infra;* Regs. 80 (1934 Ed.) Art. 13(3). While this provision was eliminated from the gift and estate tax regulations by T.D. 4901, 1939-1 Cum. Bull. 341, and T.D. 4902, 1939-1 Cum. Bull. 325, the Commissioner evidently has not fully abandoned the principle, at least in the case of gifts before 1939, as evidenced by his position in the present case and the *Maytag* case. It is true that this Court has just recently denied the Government's petition for certiorari in the *Maytag* case. That case, however, is in line with the recent decisions on the subject, while the present decision is contrary in principle. Its effect is to cause confusion and uncertainty with respect to the propriety and the application of the blockage theory.

4. The decision of the court below on the second question, involving the petitioner's right to take a gift tax exemption of $26,150 for the year 1935, is possibly not in direct conflict with any decided case. However, it presents a failure to follow a cardinal principle of the

doctrine of estoppel, namely that the party invoking the estoppel shall have acted to his detriment in reliance upon the conduct of the other, whether it should take the form of representations or acquiescence. *United States v. S. F. Scott & Sons,* 69 F. (2d) 728, 732 (C. C. A. 1st); *Helvering v. Brooklyn City R. Co.,* 72 F. (2d) 274, 276, (C. C. A. 2nd); *Helvering v. Schine Chain Theatres,* 121 F. (2d) 948, 950 (C. C. A. 2nd). And see *Bigelow on Estoppel,* 6th Edition, page 743.

In the present case the petitioner was entitled to choose the years and the amounts in which to claim his $50,000 exemption. The statute (Section 505(a)(1), Revenue Act of 1932 *infra*) provides for an exemption of $50,000 less the aggregate of the amounts "claimed and allowed as specific exemptions for preceding calendar years." Art. 12 of Regulations 79 (1936 Ed.) *infra,* specifically provides that the exemption "at the option of the donor, may be taken in its entirety in a single year, or be spread over a period of years in such amounts as he sees fit, * * *." The petitioner never elected to take more than $11,850 as an exemption for the year 1933, his sole choice with respect to the balance of $26,150 being an election to take it in the year 1935.[3] The Commissioner of his own volition applied this remaining amount against the additional gifts of the Liberty bonds which he determined were taxable gifts in 1933. In this respect he did not act in reliance upon any conduct of the petitioner.

We submit it was not incumbent on the petitioner upon appeal from the Commissioner's determination for

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3. Despite the substantial increase in the petitioner's gross gifts for 1933 as determined by the Commissioner, it was to petitioner's benefit to be allowed specific exemptions of $11,850 in 1933 and $26,150 in 1935 as claimed by him, rather than $38,000 in 1933. This is for the reason that the aggregate tax payable is less under the petitioner's treatment of his specific exemption.

1933 either to accept or reject the use of the additional exemption. It was his position on the appeal that the Liberty bonds were not taxable, and if he was correct in this, there was no occasion to make any choice with respect to the remaining exemption. But if his failure at that time to deny the exemption could in some manner be taken to amount to acquiescence, this was corrected before the expiration of the statute of limitations against assessment for 1933 by his act in claiming the exemption for 1935.[4] Further, the petitioner in his protest of August 7, 1936 excepted to the proposed disallowance of the specific exemption which he had claimed for 1935 and stated the years and the amounts in which he desired to take his exemption. (R. 27.) The Commissioner then was still entitled upon the appeal to the Circuit Court of Appeals to ask the court to remand the case for rehearing for the purpose of eliminating the additional exemption allowed for 1933, and increasing the deficiency accordingly. See Revenue Act of 1926, c. 27, 44 Stat. 9, Section 1003(b); Revenue Act of 1932, Section 513(e). *Cf. Brooklyn City R. Co., supra,* page 276.

The case of *Wheelock v. Commissioner,* 77 F. (2d) 474 (C. C. A. 5th), on which the court below relied, is not in point. There the allowance of the full cost of the equipment upon the sale was caused by the act of the taxpayer in claiming it in his return for the year 1924, and when the taxpayer later claimed the inconsistent right to deduct depreciation for the previous year it was too late to correct the year 1924, which had been settled by a closing agreement. Here there was no reliance by the Commissioner on the conduct of the petitioner, and

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4. The return for 1935 was filed prior to the Board's decision on the 1933 appeal, which was entered on June 10, 1936. (R. 26.) The statute of limitations upon assessment provided by Section 517 of the Revenue Act of 1932 expired March 15, 1937.

he was advised of the petitioner's position in sufficient time to correct his own unauthorized act. The decision of the Board and the court below is contrary to an underlying principle of estoppel as applied by the decisions above cited among others, and we submit that the point should be reviewed by this Court.

Conclusion.

It is respectfully submitted that this petition for writ of certiorari should be granted to review both of the questions discussed herein.

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